

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Telecommunications Relay Services and	)	
Speech-to-Speech Services for	)	CG Docket No. 03-123
Individuals with Hearing and Speech	)	
Disabilities	)	

**JOINT COMMENTS OF  
COMMUNICATION ACCESS CENTER FOR THE DEAF AND HARD OF  
HEARING, COMMUNICATION SERVICE FOR THE DEAF, INC.,  
GOAMERICA, INC., HANDS ON VIDEO RELAY SERVICES, INC., SNAP  
TELECOMMUNICATIONS, INC., SORENSON COMMUNICATIONS, INC.,  
AND SPRINT NEXTEL CORPORATION**

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AND SPRINT NEXTEL CORPORATION**

Communication Access Center for the Deaf and Hard of Hearing (“CAC”),  
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Hands On Video Relay Services, Inc. (“Hands On”), Snap Telecommunications, Inc.  
 (“Snap”), Sorenson Communications, Inc. (“Sorenson”), and Sprint Nextel Corporation  
 (“Sprint Nextel”) (collectively, “Joint Commenters”) submit these Joint Comments in  
response to the Further Notice of Proposed Rulemaking (“*Further Notice*”)<sup>1</sup> released in  
the above-captioned proceeding to support the adoption of a price cap regulatory  
approach to govern the rates for the provision of video relay services (“VRS”) and  
Internet Protocol (“IP”) relay services.

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<sup>1</sup> *Telecommunications Relay Services and Speech-to-Speech Services for  
Individuals with Hearing and Speech Disabilities*, Further Notice of Proposed  
Rulemaking, 21 FCC Rcd 8379 (2006) (FCC 06-106) (“*Further Notice*”).

## I. INTRODUCTION AND SUMMARY

In the *Further Notice*, the FCC asks whether it should retain its current rate methodology or replace it with a new scheme.<sup>2</sup> As explained below, the Joint Commenters support the adoption of a price cap plan for VRS and IP relay service based on the regulatory framework the FCC developed for AT&T and the larger incumbent local exchange carriers (“LECs”), including the Bell Operating Companies (“BOCs”).<sup>3</sup> As the FCC has recognized, a price cap system of regulation has many advantages compared to a cost-of-service (or rate-of-return) regulatory system.<sup>4</sup>

A price cap approach would provide the FCC with a simplified, predictable, and fair way to establish the reimbursement rate for all providers of VRS and IP Relay. Specifically, the rates for VRS and IP Relay would be capped for a minimum of three years, during which time the rates would be adjusted upward annually for inflation (according to a pre-defined inflation factor) and downward to account for efficiency gains (according to a factor also set at the outset of price caps). In the event of changes in costs beyond the control of the providers, adjustments for those changes would also be made upon approval by the Commission.

Implementing price caps for VRS and IP Relay would have at least three benefits: (1) the price cap approach creates incentives for all VRS and IP Relay providers to lower costs, whereas any cost-of-service approach creates incentives to allow reimbursable costs to go up; (2) a price cap for a minimum of three years provides firms enough

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<sup>2</sup> *Id.*, ¶¶ 20, 28.

<sup>3</sup> The Joint Commenters’ support for a price cap approach is based on the assumption that all elements are adopted substantially as proposed herein.

<sup>4</sup> “Rate-of-return” is a form of cost-of-service regulation that was used to regulate AT&T and the BOCs prior to the adoption of price caps.

predictability about revenue to allocate money to programs that will reduce costs in the future (such as hiring and training more interpreters, so as to keep labor costs low); and (3) a price cap simplifies the process and reduces the expenditure of time and money by firms, NECA, and the FCC on what has been a perennially complex and troublesome process of rate setting.

## **II. IMPLEMENTATION OF PRICE CAPS**

We describe here the components of the price cap approach developed for the LECs and follow that with an explanation of how to address each component in the context of VRS and IP Relay.

### **A. Background: LEC Price Caps**

The Commission has previously concluded that for AT&T and the LECs, a price cap approach is far better than a rate-of-return approach in promoting efficiency and reducing administrative burdens.<sup>5</sup> Traditional rate-of-return regulation encourages firms to expand their regulated investment to increase their returns, while generally not permitting firms to benefit from the savings they might gain by reducing their cost of providing service.<sup>6</sup> The Commission's price cap rules, by contrast, encourage firms to introduce cost-saving measures by permitting them to retain all or part of those savings, as long as their prices remain below the indexed maximum.<sup>7</sup> In this regard, the

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<sup>5</sup> See *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶¶ 21, 37 (1990) ("*LEC Price Cap Report and Order*"); *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, ¶¶ 36-37, 85 (1989) ("*AT&T Price Cap Report and Order*").

<sup>6</sup> *AT&T Price Cap Report and Order*, ¶ 30.

<sup>7</sup> *LEC Price Cap Report and Order* ¶ 2; see also *AT&T Price Cap Report and Order* ¶ 42.

incentives created by a price cap system emulate the incentives to innovate and lower costs that exist in a competitive marketplace.<sup>8</sup> As such, a price cap plan for VRS and IP Relay would foster greater innovation and competition, consistent with key Commission and congressional objectives. A price cap plan that is put in place for a minimum of three years would also provide firms with the predictability necessary to allocate funds toward near-to-long-term cost reduction measures. Finally, price caps reduce administrative burdens and costs by eliminating the need for periodic cost reviews. In the case of VRS and IP Relay, this would mean at the very least that NECA, the FCC, and providers would be freed of the significant burdens and costs associated with annual filings and projections, as well as the attendant audits, reviews, disputes, and the like that are part and parcel of the current regulatory regime.

In implementing price caps for incumbent LECs, the Commission established a formula for ongoing adjustments to the rates. The FCC's price cap formula for the LECs has three basic components: (1) an inflation factor; (2) a productivity measure (also called the "X-factor"), as well as a consumer productivity dividend (CPD); and (3) a provision for cost changes beyond the control of the provider (termed "exogenous" cost changes) that are not captured by the inflation adjustment. The inflation factor was designed to reflect the fact that providers must pay real, not nominal, wages and other expenses. This adjustment was intended to do no more than keep providers whole, assuming that inflation in the telecommunications industry approximates inflation in the

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<sup>8</sup> *LEC Price Cap Report and Order* ¶ 2; *AT&T Price Cap Report and Order* ¶ 36 ("The attractiveness of incentive regulation lies in its ability to replicate more accurately than rate of return the dynamic, consumer-oriented process that characterizes a competitive market.").

economy as a whole.<sup>9</sup> The productivity adjustment originally was designed to reflect the extent to which efficiency gains in the telecommunications industry historically outstripped efficiency gains achieved in the economy as a whole.<sup>10</sup> The exogenous cost provision was intended to account for the fact that LECs' costs may increase as a result of changes in regulatory requirements or other LEC-specific changes that would not be captured by the national measure of inflation.<sup>11</sup> The Commission initiated price caps by using the most recent LEC cost-of-service rates as a basis for the price cap indices, and applied the price cap formula going forward, resulting in annual adjustments to the caps.<sup>12</sup> Finally, the FCC provided for a performance review of the price cap mechanism in the fourth year.<sup>13</sup>

#### **B. Price Cap Formula Applied to VRS and IP Relay**

The price cap formula adopted for the LECs provides a good basis for establishing price caps for VRS and IP Relay. However, the approach must be adjusted to account for the differences between the capital-intensive telephone industry and the

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<sup>9</sup> See, e.g., *Policy and Rules Concerning Rates for Dominant Carriers*, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, ¶ 346 (1988) ("*Price Cap FNPRM*").

<sup>10</sup> See *LEC Price Cap Report & Order* ¶ 48. Subsequently, in the *CALLS Order*, the FCC set the X-factor equal to the inflation factor and treated the X-factor not as a productivity estimate, but as a way of effectively freezing price caps. *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249; Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962, ¶ 141 (2000) ("*CALLS Order*").

<sup>11</sup> See *LEC Price Cap Report and Order* ¶ 48.

<sup>12</sup> See *id.* ¶¶ 230-244. The FCC also used the most recent cost-of-service rates of AT&T as the basis for the AT&T price cap indices. See *AT&T Price Cap Report and Order* ¶ 424.

<sup>13</sup> See *LEC Price Cap Report and Order* ¶¶ 385-386.

labor-intensive nature of providing VRS and IP Relay. Notably, the way to gain efficiencies in VRS and IP Relay is to restrain labor prices and to use interpreters as efficiently as possible. To this end, a rate methodology should provide firms with incentives to recruit, train, and retain qualified interpreters. Otherwise, increased demand for a limited pool of experienced ASL interpreters will cause total labor costs to increase substantially. Under any approach, these labor costs must be reimbursed. So, if firms lack incentives to keep costs down, the reimbursable rates will necessarily increase, thereby causing a proportional increase in the size of the fund. Paradoxically, the result would be that service quality to deaf users would not improve, yet costs would increase substantially, a result that cannot be in the public interest. The price cap system proposed here would create incentives that encourage all firms to keep labor costs down by increasing the supply of qualified interpreters and using interpreters' services as efficiently as possible.

The Joint Commenters propose the following price cap formula for VRS and IP Relay, and discuss the individual components below:  $\text{Rate}_{\text{Year } Y} = \text{Rate}_{\text{Year } Y-1} (1 + \text{GDP-PI} - (X + 0.005))$ . If  $X = \text{GDP-PI}$ , then  $\text{Rate}_{\text{Year } Y} = \text{Rate}_{\text{Year } Y-1} (1 - 0.005)$ .<sup>14</sup>

1. Inflation Factor

For VRS and IP Relay, the FCC should adopt the same general inflation factor relevant to the economy as a whole that it adopted in its price cap plans for AT&T and the LECs. In choosing the appropriate inflation factor for incumbent LECs, the FCC

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<sup>14</sup> As in the FCC's price cap plan for LECs, the GDP-PI used in the filing effective on July 1<sup>st</sup> of each year would be measured as the percentage change in the GDP-PI reported by the Department of Commerce from the fourth quarter of the calendar year two years before the filing to the fourth quarter of the preceding calendar year. Thus, in 2007, the GDP-PI would be measured as the change in the reported GDP-PI from the fourth quarter 2005 to the fourth quarter 2006.

sought an index that would “capture inflationary changes that the carriers themselves face.”<sup>15</sup> The Gross Domestic Product – Price Index (“GDP-PI”) is the general inflation factor that is also currently used in the price cap formula for the incumbent LECs.<sup>16</sup> The GDP-PI is more broadly based than the Consumer Price Index (“CPI”) because it covers the prices of all goods and services in the economy, including those purchased by businesses, rather than just the basket of items purchased by consumers that are reflected in the CPI. The GDP-PI will reflect two effects – the changes in: (1) the prices of inputs, and (2) the average efficiency among all firms in the economy in using those inputs. It represents a conservative inflation factor because the specialized labor costs for VRS and IP Relay are likely to increase more than labor costs for the general economy (particularly in the near term when long-term investments in training qualified interpreters still have not produced a sufficient labor supply to meet the increase in demand).

## 2. Efficiency Factor

The productivity factor (or “X-factor”) for VRS and IP Relay should be established in a manner that takes advantage of incentives to become more efficient and also ensures that cost savings from efficiency gains are shared with contributors to the fund. In prescribing an X-factor for the LECs, the Commission found that the productivity gains of those carriers consistently outperformed the gains achieved by the economy as a whole. This is because telecommunications carriers traditionally have

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<sup>15</sup> *Price Cap FNPRM* ¶ 346.

<sup>16</sup> 47 C.F.R. § 61.45. The Commission originally adopted a different inflation factor – the GNP-PI, but changed to the GDP-PI in 1995 because of changes in the Department of Commerce publications. *Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, ¶¶ 347-351 (1995).

increased their productivity by increasing the volume of traffic carried over fixed, non-traffic sensitive plant or by expanding the array of products offered over the same plant. Consequently, incumbent LECs enjoy very substantial economies of scope and scale in the provision of local telephone service.

By contrast, although productivity gains for the VRS and IP Relay industries have not been measured, it is unlikely that VRS and IP relay service providers will be able to achieve the same type of productivity gains that the telecommunications industry historically has achieved. Unlike traditional telecommunications services, VRS and IP relay services are labor-intensive, and labor costs, principally wages of interpreters and communications assistants, account for the majority of providers' costs. In addition, there is very little scope for substituting away from the use of labor to provide service. Furthermore, telecommunications costs are a very small fraction of the total costs of VRS and IP Relay. Moreover, unless providers have increased incentives to keep wages down (*e.g.*, by investing in interpreter training programs), wage increases for qualified interpreters are likely to be greater than average wage increases across the economy, as increased demand for VRS places greater pressure on limited interpreting resources.<sup>17</sup>

In these circumstances, the FCC could reasonably decide to set an X-factor for VRS and IP Relay services by following an approach it used in setting the annual

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<sup>17</sup> See, *e.g.*, *Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, Report and Order, 20 FCC Rcd 13165, ¶18 (2005) (“[W]e recognize . . . that there may not presently be a sufficient number of qualified interpreters to permit VRS providers to meet a speed of answer rule that approaches the present rule applicable to the other forms of TRS. We also recognize that as VRS providers hire interpreters in greater numbers to meet the demand of VRS users, there are fewer community interpreters available to meet the needs of persons with hearing disabilities in other circumstances (*e.g.*, in schools, hospitals, business meetings, etc.).”).

adjustment for the price cap indices of the LECs. As part of the CALLS plan adopted in 2000, the FCC provided that the annual X-factor adjustment to the price cap indices would be set equal to GDP-PI, which has the effect of freezing the caps for the LECs.<sup>18</sup> That is, the upward pressure that would otherwise occur because of the inflation factor is offset by the downward pressure from the X-factor. In the case of VRS and IP Relay service, this approach would have the effect of forcing rates downward in real terms over time, though they would remain constant in nominal terms.

The Commission has previously included in its price cap formula an adjustment to provide a “consumer productivity dividend” (CPD).<sup>19</sup> The Commission’s theory in the past has been that the introduction of price caps for a minimum period would enhance the incentives of carriers to exceed their historical productivity gains. The Commission concluded that the cost savings that would result from the enhanced incentives should be shared immediately with rate payers, and added 0.5 percent (0.005) to the X-factor to accomplish that result.<sup>20</sup> The FCC’s existing approach to VRS and IP Relay rates provides an incentive for providers to become more efficient than the “reasonable” provider. The implementation of a price cap-type approach to VRS and IP Relay rates for a minimum of three years, however, clearly would strengthen those incentives. Consequently, the Commission could reasonably find that in these circumstances, the annual adjustment to account for productivity gains should be increased by 0.5 percent to reflect the greater efficiency gains it expects providers to achieve over the next three years.

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<sup>18</sup> *CALLS Order* ¶ 141.

<sup>19</sup> *LEC Price Cap Report and Order* ¶ 76.

<sup>20</sup> *CALLS Order* ¶ 135.

Thus, under the approach discussed above, the price cap formula for VRS and IP Relay rates would be:  $\text{Rate}_{\text{Year } Y} = \text{Rate}_{\text{Year } Y-1} (1 + \text{GDP-PI} - (X + 0.005))$ . If X were set equal to GDP-PI as proposed here, this would simplify to  $\text{Rate}_{\text{Year } Y} = \text{Rate}_{\text{Year } Y-1} (1 - 0.005)$ . This approach would put pressure on providers to look for efficiency gains. It is consistent with the approach the Commission has used with AT&T and the LECs. It is a useful, practical, and tested approach to modern day price cap systems.

### 3. Exogenous Costs

The Commission should adopt a definition for “exogenous costs” similar to that adopted for the LECs: costs that are beyond the control of VRS and IP relay service providers and that are not reflected in the inflation adjustment.<sup>21</sup> In order to provide for certainty as to which costs will be afforded exogenous treatment, we propose that in any order adopting regulatory changes, the Commission would determine whether the new rules warrant an exogenous adjustment. If so, the FCC would permit an appropriate adjustment to the rate index at the time the additional costs are incurred.<sup>22</sup> The FCC would determine the adjustment to the rate formula based on providers’ filings. These filings would describe the proportion of providers’ costs affected by the exogenous event (expressed as a percentage of total costs) and the extent to which those costs are affected by the exogenous event (again, expressed as a percentage increase or decrease). As with

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<sup>21</sup> *LEC Price Cap Report and Order* ¶ 48 (“Exogenous cost changes are generally outside the carrier’s managerial control and are often the product of this Commission’s own regulatory actions.”); *see also id.* ¶ 166 (“Exogenous costs are in general those costs that are triggered by administrative, legislative or judicial action beyond the control of the carriers . . . . [T]hese are costs that should result in an adjustment to the cap in order to ensure that the price cap formula does not lead to unreasonably high or unreasonably low rates.”).

<sup>22</sup> For example, if the FCC were to require VRS and IP Relay providers to offer E911, the costs incurred by providers to comply with the application of E911 requirements should be treated as exogenous for purposes of price caps.

the LECs, if the costs were ongoing, the formula adjustment would be ongoing. For one-time costs, the exogenous change would be reversed out at a future date.

### C. Initial VRS and IP Relay Rates

The formula described above must be applied to specified rates in order to initiate the price caps for both VRS and IP Relay.<sup>23</sup> As discussed above, for incumbent LECs and AT&T, the Commission used the most recent cost-of-service rates.

In establishing the initial rate under a VRS price cap regime, the Commission should adopt the 2005-2007 VRS rate of \$6.644 per minute. The Commission has found this rate to be just and reasonable.<sup>24</sup> Moreover, this rate has proven to be effective in providing incentives for providers to improve access to VRS.

For IP relay services, the FCC should use the current IP Relay rate of \$1.293 per minute.<sup>25</sup> IP relay service rates have varied only minimally in the past four years and the current rate of \$1.293 per minute is at the lower end of the range.

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<sup>23</sup> Unlike price cap indices for the incumbent LECs which applied to the provision of a range of different services, the price cap indices for VRS providers and IP relay service providers would each cap reimbursement rates for only one service: VRS and IP relay services, respectively. Consequently, annual price cap adjustments would be made directly to VRS and IP Relay rates rather than to an index.

<sup>24</sup> *Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, Order, 20 FCC Rcd 12237, ¶ 28 (2005). The FCC found that extension of this rate for another year would be in the public interest. *Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, Order, 21 FCC Rcd 7018, ¶ 29 (2006) (“2006 Rate Order”). Compare *LEC Price Cap Order* ¶ 232 (discussing initial rates for incumbent LEC price caps: “The rates resulting from [the oversight] process, while not perfect, in general represent the best that rate of return regulation can produce.”).

<sup>25</sup> *2006 Rate Order* ¶ 1.

#### **D. Price Cap Performance Review**

As with the LECs, it is important to have price caps in place for at least three years before revisiting the formula, based on a performance review. The FCC commenced its “performance review” of the incumbent LEC price cap plan during the fourth year of the plan.<sup>26</sup> The Commission explained that

[t]o provide a fair evaluation of the program, it is also important that the initial period before periodic review and the possibility of major adjustments be long enough for incentives to operate. We believe that a four-year period without major adjustment (to, for example, the productivity factor) is reasonable. The real test of any such program is experience. Failure to provide a reasonable period of acclimation could result in regulatory ambiguity, and resulting uncertainty, that would effectively stifle the intended incentives.<sup>27</sup>

A similar time period is warranted for VRS and IP relay service.

For VRS and IP Relay, the Commission should impose the price cap formula described above, beginning on July 1, 2007. The formula would be applied to the current IP Relay and VRS rates, resulting in a decline in rates on July 1, 2007 and in subsequent years, absent exogenous changes. In 2010, the Commission should commence its review of the formula and thereafter make any adjustments that are required. The review should seek to determine whether the price cap plan is promoting the achievement of statutory goals for each service. For VRS, the Commission should consider factors such as whether there has been an increase in the number of VRS minutes provided (as well as any trending in that number), the number of interpreters and the impact on interpreter training programs, the net entry or exit of VRS providers (and the cause of entry or exit),

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<sup>26</sup> *LEC Price Cap Report and Order* ¶ 385.

<sup>27</sup> *Id.* ¶ 386.

and any changes in VRS service quality levels. Similarly, for IP Relay, the Commission should consider factors such as the number of minutes of IP relay services that are provided (as well as any trending in that number), the net entry and exit of IP relay service providers (and the reasons for exit or entry), and changes in the quality of IP relay services. If the review were to demonstrate that changes were needed in the price cap plans for either or both services, the Commission could modify the formulas as needed, on a prospective basis.

### III. CONCLUSION

For the foregoing reasons, the Joint Commenters respectfully request that the Commission adopt a price cap methodology for establishing VRS and IP relay service reimbursement rates, consistent with the proposals outlined herein.

Respectfully submitted,

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